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Practice

Informal Guidance Is the IRS's Newest Enforcement Tool

By Andrew R. Roberson and Kevin Spencer

Over the last several years, there has been a dramatic increase in the issuance of informal guidance by the Internal Revenue Service ("IRS"). Why is this important? Informal guidance is what IRS revenue agents look to when proposing adjustments to taxpayers' returns. Revenue agents may feel constrained to follow the guidance even though it has not been vetted by an impartial arbiter like a court or undergone scrutiny by the public, the U.S. Department of the Treasury, or Congress. This then makes resolving issues with the IRS at the examination and even Appeals levels increasingly more difficult when faced with one-sided, aggressive, and sometimes not well-reasoned IRS pronouncements.

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In this column, we discuss the various types of informal guidance that the IRS has been issuing, and whether and when taxpayers can rely upon the guidance for their benefit. Our goal is to look at IRS informal guidance from a strategic perspective to help taxpayers best position their matters before the IRS.

A. What Is IRS Informal Guidance?

In 2016, the U.S. Government of Accountability Office released a report on the regulatory guidance process and the need for the government to re-evaluate certain areas (the "GAO Report").[1] Included with the GAO Report was a helpful chart (*see* Chart 1).

As the GAO chart reflects, the IRS issues numerous forms of guidance, and the type of guidance issued can be important to whether the IRS and taxpayers are required to follow the guidance.

The IRS publishes so-called "sub-regulatory guidance" which is guidance that it publishes in the weekly Internal Revenue Bulletin ("IRB"). Sub-regulatory guidance includes Revenue Rulings, Revenue Procedures, Notices, and Announcements.

Further complicating the landscape of guidance, the IRS publishes most of its internal guidance so the public knows the agency's positions. One category of published guidance is "Written Determinations," which include private letter rulings ("PLR"), determination letters, technical advice memoranda, and Chief Counsel Advice. Pursuant to Code Sec. 6110, a written determination must be made public for all taxpayers to review. Stripped from the public

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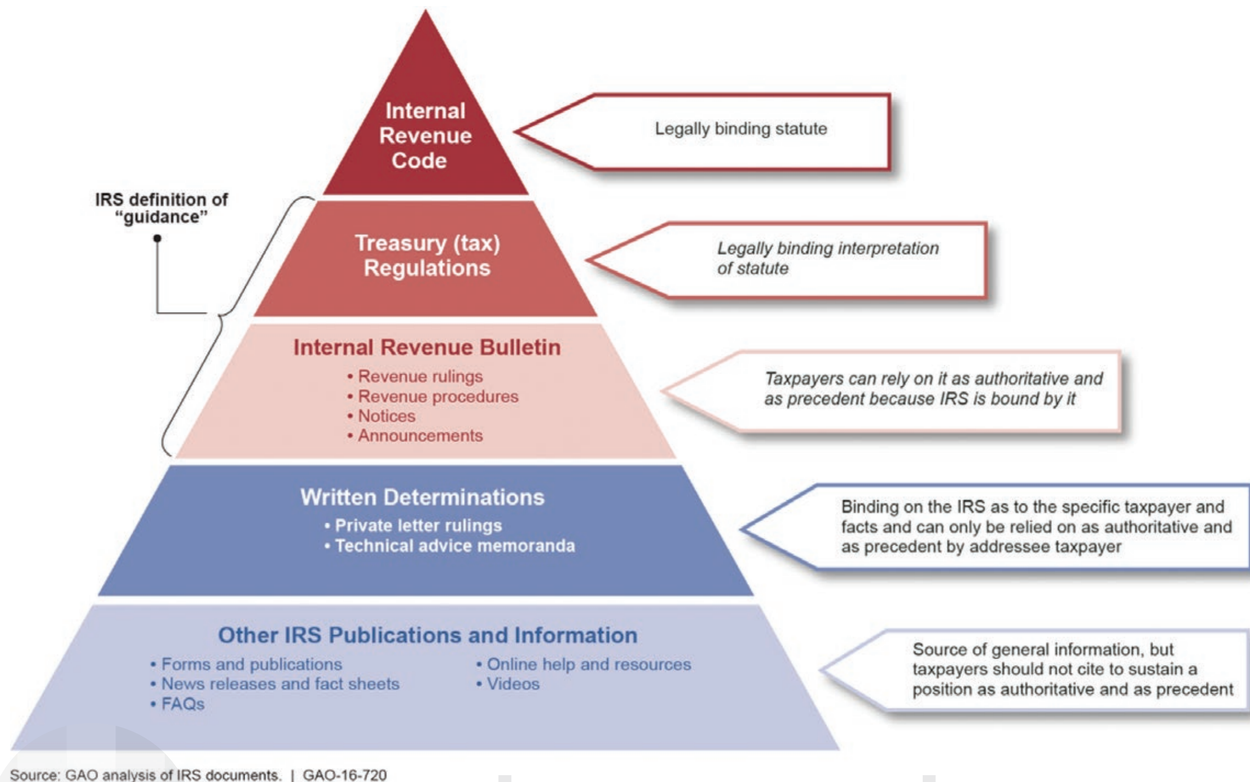
CHART 1. HIERARCHY OF AUTHORITY FOR IRS GUIDANCE AND OTHER INFORMATION SOURCES



Source: GAO analysis of IRS documents. | GAO-16-720

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version of these written determinations, however, is any information that could identify the specific taxpayer to which the written determination relates. But importantly, a written determination may not be used or cited as precedent.[2] This means that neither the IRS nor other taxpayers are bound by the conclusions reached in the written determination.[3]

The IRS also issues internal guidance to its employees and to the general public (referred as "Other IRS Publications and Information" in Chart 1). Internal guidance includes, but is not limited to, the Internal Revenue Manual, Practice Units, Chief Counsel Directive Manual, Audit Technique Guidelines, Appeals Settlement Guidelines, General Legal Advice Memorandum ("GLAM"), Instructions to IRS forms, Frequently Asked Questions ("FAQs"), Legal Memoranda, and Non-Docketed Significant Advice Review. Generally, these forms of guidance are not binding on the IRS or taxpayers, and merely demonstrate the IRS's perspective on a set of hypothetical facts or provide generally applicable guidance to taxpayers and IRS personnel.

With a panoply of IRS guidance, what does it all mean? When does the IRS have to follow it? If a taxpayer follows the guidance, is it a safe harbor? If a taxpayer does not follow the guidance, does the taxpayer's position automatically get challenged by the IRS and lose? Can taxpayers rely on the guidance to avoid or abate civil tax penalties? We explore these questions below.

B. Does the IRS Have to Follow Its Own Guidance?

The answer depends on the type of guidance. The IRS is bound to follow federal statutes, Treasury Regulations, international treaties, and applicable case law.[4] In addition, the IRS treats sub-regulatory guidance as binding.[5] The IRS, however, is not bound to follow any other type of guidance that it issues.[6] Of course, optically it looks bad for a government agency to refuse to follow its public pronouncements (even when they are not published in the IRB).

We have found that an effective argument with the IRS when advocating for a taxpayer is to align with the IRS's conclusion in informal guidance if possible. Be cognizant that the IRS may try to argue that the facts

and circumstances in the informal guidance are different from the taxpayer's position. But before a more neutral arbiter like an IRS Appeals Officer or even a court, when the IRS takes a position that is contrary to a position it has taken for another taxpayer or that it publishes to the general public, the onus is on the IRS to explain why.[7]

Of course, if the IRS tries to use, for example, a PLR to argue against your position, a good technique is to remind the IRS agent or officer that such a ruling is not binding and may not be used or cited as precedent.[8] Another technique is to highlight differences of the facts in the ruling as compared to the circumstances of the taxpayer.

C. Is IRS Informal Guidance a "Safe Harbor"?

"What is good for the goose is good for the gander." Just like informal guidance is not binding on the IRS, it is also not a safe harbor for taxpayers. Merely because the IRS states a position regarding a set of hypothetical facts in informal guidance does not mean that the taxpayer can rely on it and get automatic protection of its position in reliance of the guidance. Indeed, the doctrine of equitable estoppel typically does not apply to the IRS.[9]

The application of tax law applies based upon the unique facts and circumstances presented in each case. Informal guidance issued by the IRS is merely meant to give taxpayers and the public a view into how the IRS thinks about an issue. This does not mean, of course, that you cannot and should not use the IRS's informal guidance to advocate for your position. But it does mean that the IRS is not bound to agree to your position simply because there is a GLAM or FAQ that seems to fit the same fact pattern.

D. Can IRS Informal Guidance Help to Avoid or Abate Civil Tax Penalties?

Yes! The IRS can assert numerous types of civil tax penalties for taxpayer noncompliance.[10] The typical civil tax penalties that the IRS asserts are for filing a return late,[11] failing to pay tax timely,[12] and so-called "accuracy-related" penalties.[13] The primary way to abate a typical civil tax penalty is for the taxpayer to show it had "reasonable cause" for the failure to comply and acted in good faith.[14] Reasonable cause:

> [I]s based on all the facts and circumstances in each situation and allows the IRS to provide relief from a penalty that would otherwise apply. Reasonable cause relief is generally granted when the taxpayer exercised ordinary business care and prudence in determining his or her tax obligations but was nevertheless unable to comply with those obligations.[15]

Reliance on IRS oral or written advice can be a basis for showing the taxpayer exercised ordinary business care and prudence. The IRS is required "to abate any portion of any penalty attributable to erroneous written advice furnished by an officer or employee of the IRS acting in his or her official capacity."[16] Indeed, Code Sec. 6404(f)(1) provides:

> The Secretary shall abate any portion of any penalty or addition to tax attributable to erroneous advice furnished to the taxpayer in writing by an officer or employee of the Internal Revenue Service, acting in such officer's or employee's official capacity.

There is, however, a qualification to this "get out of jail free card"—"the written advice was reasonably relied upon by the taxpayer and was in response to a specific written request of the taxpayer."[17] So for automatic protection from civil penalties, the taxpayer must have made a specific request from the IRS, received advice from the IRS, and reasonably relied on the advice to abate the penalty under the statute.

The IRM informs that abate can still be proper even if the taxpayer cannot fit within the strictures of the statute:

> If the taxpayer does not meet the criteria for penalty relief under IRC 6404(f), the taxpayer may qualify for other penalty relief. For instance, taxpayers who fail to meet all of the IRC 6404(f) criteria may still qualify for relief under reasonable cause if the IRS determines that the taxpayer exercised ordinary business care and prudence in relying on the IRS's written advice. See IRM 20.1.1.3.2.2.5, Erroneous Advice or Reliance.[18]

Accordingly, if the taxpayer cannot show that it qualifies for abatement of a penalty under Code Sec. 6404(f), the taxpayer can still abate the penalty that it "exercised ordinary care and prudence in relying on the IRS's advice."[19] The IRS should be hard-pressed to say that a taxpayer did not exercise ordinary care and prudence when it relied upon IRS informal guidance that is available to the general public.

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E. Substantial Authority Who?

We highlight a specific accuracy-related penalty to focus on if and when informal guidance can constitute "substantial authority" for the taxpayer.[20] One of the bases for an accuracy-related penalty in Code Sec. 6662(d) is a "substantial understatement of income tax."[21] An understatement, however, is reduced "by that portion of the understatement which is attributable to—(i) the tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment …."[22]

Tax controversy is more art than science. To prevail in the most favorable way, practitioners and taxpayers have to be creative and advocate for their positions. The IRS's newfound respect for its FAQs makes the line between binding authority and helpful, informal guidance a bit blurry.

The "substantial authority" standard is an objective standard involving an analysis of the law and application of the law to relevant facts.[23] It is less stringent than the "more likely than not" standard,[24] but more stringent than the reasonable basis standard in Reg. §1.6662-3(b)(3).[25] The regulations explain that you perform an analysis to determine whether the weight of the authorities supporting the treatment is substantial in relation to the weight of authorities supporting contrary treatment.[26] Important to our discussion:

> All authorities relevant to the tax treatment of an item, including the authorities contrary to the treatment, are taken into account in determining whether substantial authority exists.[27]

Not all "authorities" are used to make this determination—only the following can be considered in the analysis:

> [A]pplicable provisions of the Internal Revenue Code and other statutory provisions; proposed, temporary and final regulations construing such statutes; revenue rulings and revenue procedures; tax treaties and regulations thereunder, and Treasury Department and other official explanations of such treaties; court cases; congressional intent as reflected in committee reports, joint explanatory statements of managers included in conference committee reports, and floor statements made prior to enactment by one of a bill's managers; General Explanations of tax legislation prepared by the Joint Committee on Taxation (the Blue Book); private letter rulings and technical advice memoranda issued after October 31, 1976; actions on decisions and general counsel memoranda issued after March 12, 1981 (as well as general counsel memoranda published in pre-1955 volumes of the Cumulative Bulletin); Internal Revenue Service information or press releases; and notices, announcements and other administrative pronouncements published by the Service in the Internal Revenue Bulletin.

Additionally, substantial authority may exist in the absence of certain types of authority if the taxpayer's position is supported only by a well-reasoned construction of the applicable statutory provision.[28] Absent from this list is a plethora of IRS informal guidance. This means that those statements cannot be considered in whether the taxpayer had substantial authority for its position.

F. The Posterchild for IRS Informal Guidance—FAQs

To quickly disseminate information to the public, the IRS has increasingly resorted to issuing FAQs on its website. FAQs provide a window into the IRS's position regarding procedural and substantive issues, and taxpayers have been wondering whether they can rely on those FAQs when taking positions on their return. That question was finally answered on October 15, 2021, when the IRS issued a news release and fact sheet to explain the significance and ability to rely on FAQs to avoid or abate civil tax penalties.[29]

The FAQ news release explains in pertinent part that:

> FAQs that have not been published in the Bulletin will not be relied on, used, or cited as precedents

by Service personnel in the disposition of cases. Similarly, if an FAQ turns out to be an inaccurate statement of the law as applied to a particular taxpayer's case, the law will control the taxpayer's tax liability. Only guidance that is published in the Bulletin has precedential value.

Notwithstanding the non-precedential nature of FAQs, a taxpayer's reasonable reliance on an FAQ (even one that is subsequently updated or modified) is relevant and will be considered in determining whether certain penalties apply. Taxpayers who show that they relied in good faith on an FAQ and that their reliance was reasonable based on all the facts and circumstances will not be subject to a penalty that provides a reasonable cause standard for relief, including a negligence penalty or other accuracy-related penalty, to the extent that reliance results in an underpayment of tax. See Treas. Reg. §1.6664-4(b) for more information. In addition, FAQs that are published in a Fact Sheet that is linked to an IRS news release are considered authority for purposes of the exception to accuracy-related penalties that applies when there is substantial authority for the treatment of an item on a return. See Treas. Reg. §1.6662-4(d) for more information.

The IRS subsequently updated its website on FAQs to provide, in relevant part[30]:

Notwithstanding the non-precedential nature of FAQs, a taxpayer's reasonable reliance on an FAQ (even one that is subsequently updated or modified) is relevant and will be considered in determining whether certain penalties apply. Taxpayers who show that they relied in good faith on an FAQ and that their reliance was reasonable based on all the facts and circumstances will not be subject to a penalty that provides a reasonable cause standard for relief, including a negligence penalty or other accuracy-related penalty, to the extent that reliance results in an underpayment of tax. See Treas. Reg. §1.6664-4(b) for more information. In addition, FAQs that are published in a Fact Sheet that is linked to an IRS news release are considered authority for purposes of the exception to accuracy-related penalties that applies when there is substantial authority for the treatment of an item on a return. See Treas. Reg. §1.6662-4(d) for more information.

These are important and positive developments for taxpayers. The IRS acknowledged for the first time that even non-taxpayer-specific informal guidance that does not rise to the level of an authority that could be determined in a substantial authority analysis still could be used to state a claim for reasonable cause and abate a civil tax penalty.

But why stop at FAQs? Why could not other forms of informal IRS guidance be used to state a case of reasonable cause. Indeed, an FAQ is likely considered the least detailed and analytic pronouncement by the IRS. Consider the analysis that exists in a typical GLAM. Should not reasonable reliance on the analysis of a GLAM rise to the level of reasonable cause if an FAQ can? We think so.

G. Takeaways

Tax controversy is more art than science. To prevail in the most favorable way, practitioners and taxpayers have to be creative and advocate for their positions. The IRS's newfound respect for its FAQs makes the line between binding authority and helpful, informal guidance a bit blurry. But optics count when engaging with the IRS on a disputed position. The more ammunition you have, the better chance you will have for achieving a positive outcome.

We strongly suggest that before you enter the ring with the IRS, you thoroughly review and research all of the sources of potentially helpful authority that exists for your position, and if possible present your position in line with what the IRS has already publicly said in the past. No mind that the IRS's pronouncements take the form of nonbinding, informal guidance like an entry in the IRM, GLAM, or FAQ. The key is to play to your strength and try to fit in those facts and analysis.

And even if that strategy will not assist you prevailing on the merits of the tax position, at the very least the IRS should not be able to assert a civil tax penalty against you where you can show that you followed the guidance, your reliance was reasonable in light of the facts and circumstances, and that reliance occurred before the return was filed. To buttress your position, consider drafting a "memo to the file" explaining what guidance you relied upon and attach a copy of the guidance to the memo. When the IRS comes snooping around, you can easily and quickly pull out your memo, which should in all events take penalties immediately off the table and likely provide substantial support for the merits of the substantive position.

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ENDNOTES

[1] *Regulatory Guidance Processes: Treasury and OMB Need to Reevaluate Long-standing Exemptions of Tax Regulations and Guidance*, GAO-16-720 (Sept. 6, 2016), available online at *www.gao.gov/products/gao-16-720* (last visited Nov. 22, 2021).

[2] *See* Code Sec. 6110(k)(3) ("Unless the Secretary otherwise establishes by regulations, a written determination may not be used or cited as precedent"). A "written determination" is "a ruling, determination letter, technical advice memorandum, or Chief Counsel advice." *See* Code Sec. 6110(b)(1).

[3] Of course, as to the specific taxpayer about which the written determination was created, the IRS agrees to follow the conclusions stated in the written determination.

[4] Note that the IRS sometimes announces that it will not follow certain federal court decisions. The IRS announces this position in an "Action on Decision," which generally provides that the IRS non-acquiesces in a particular case or holding in that case and will not follow it except to the extent the issue arises in the same venue and therefore is binding precedent. *See* IRM 36.3.1 (Mar. 14, 2013), available online at *www.irs.gov/actions-on-decisions* (last visited Dec. 20, 2021).

[5] *See* Rev. Proc. 89-14, 1989-1 CB 814; Reg. §601.601(d)(2)(v)(d); Notice CC-2003-014. The IRS published the 2003 notice after the U.S. Tax Court reminded the IRS that it must adhere to its published positions. *See G.A. Rauenhorst*, 119 TC 157, Dec. 54,899 (2002) (treating IRS position in published guidance as a concession as to the proper result in a case and citing long-standing case law to support this point).

[6] Excepted from this statement are written determinations with respect to the taxpayer to whom it applies, assuming that the substantive facts have not changed when the position is claimed on the tax return from the assumed facts in the ruling request. We note that IRS positions taken in informal guidance may be cited to show the IRS's administrative practice and position, and may be instructive in certain situations. *See, e.g.*, *Rowan Cos.*, 542 US 247, 261 n 17 (1981); *G.A. Rauenhorst*, 119 TC at 170 n 8.

[7] The IRS generally treats similarly situated taxpayer's similarly. *See Kaiser*, 363 US 299, 308 (1960) (Frankfurter, J., concurring) ("The Commissioner cannot tax one and not tax another without some rational basis for the difference."); *W.L. Becker*, 85 TC 291, 294, Dec. 42,317 (1985) (quoting *Kaiser* with approval); *Oshkosh Truck Corp.*, CA-FC, 97-2 USTC ¶70,084, 123 F3d 1477 (same)s; *see also* Steve R. Johnson, *An IRS Duty of Consistency: The Failure of Common Law Making and a Proposed Statutory Solution*, 77 Tenn. L. Rev. 563 (2010).

[8] *See* Code Sec. 6110(k)(3).

[9] The doctrine of equitable estoppel can apply when a party makes a representation to another party upon which the second party reasonably relies. In that case, the party making the representation is estopped from taking the position that the representation was false. *See, e.g.*, Fred Ansell, *Unauthorized Conduct of Government Agents: A Restrictive Rule of Equitable Estoppel Against the Government*, 53 U. Chi. L. Rev. 1026 (1986); Stephanie Hoffer, *Hobgoblin of Little Minds No More: Justice Requires an IRS Duty of Consistency*, 2006 Utah L. Rev. 317, 333–334 (2006); Ann K. Wooster, *Taxpayer's Assertion of Equitable Estoppel Against IRS Based on Representations of IRS or Non-IRS Employees*, 176 A.L.R. Fed. 33 (2002) (summarizing existing case law). *See also* Note, *Equitable Estoppel of the Federal Government: An Application of the Proprietary Function Exception to the Traditional Rule*, 55 Fordham L. Rev. 707 (1987).

[10] Civil tax penalties "exist to encourage voluntary compliance by supporting the standards of behavior required by the Internal Revenue Code." IRM 20.1.1.2 (Nov. 21, 2017).

[11] *See* Code Sec. 6651(a).

[12] *See* Code Sec. 6651(b).

[13] *See* Code Sec. 6662. Code Sec. 6662 imposes a tax penalty applicable to "any portion of an underpayment of tax required to be shown on a return, there shall be added to the tax an amount equal to 20 percent of the portion of the underpayment" attributable to, for example, negligence or disregard of the tax rules and regulations and a substantial understatement of income tax. We do not intend to cover the gambit of potential civil tax penalties that the IRS could assert, as each penalty relies on a specific set of facts and circumstances. *See* Andrew R. Roberson and Kevin Spencer, *Expect More Civil Tax Penalties—So, Now What?* The Tax Executive (Sept. 27, 2019). We do highlight some common civil tax penalties for illustration purposes.

[14] "No penalty shall be imposed under section 6662 … with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion." Code Sec. 6664(c)(1).

[15] IRM 20.1.1.3.2 (Nov. 21, 2017).

[16] *See* IRM 20.1.1.3.3.4.1 (Nov. 25, 2011).

[17] Code Sec. 6404(f)(2)(A).

[18] IRM 20.1.1.3.3.4.1 (Nov. 25, 2011).

[19] IRM 20.1.1.3.2.2.5(3) (Nov. 21, 2017).

[20] Whether a taxpayer has substantial authority for a position reported on a return is also important for Code Sec. 6694 purposes. We leave that discussion for another day.

[21] A substantial understatement of income occurs when during any taxable year the amount of the tax understatement exceeds 10 percent of the tax required to be shown on the return or $10,000. *See* Code Sec. 6662(d)(1)(A). A special rule for corporations increases the minimum understatement to 10 percent of the tax required to be shown on the return or $10 million. *See* Code Sec. 6662(d)(1)(B).

[22] Code Sec. 6662(d)(2)(B).

[23] *See* Reg. §1.6662-4(d)(2).

[24] The more likely than not standard is met when there is a greater than 50-percent likelihood of the position being upheld. *See id.*

[25] *Id.*

[26] *See* Reg. §1.6662-4(d)(3)(i).

[27] Reg. §1.6662-4(d)(3).

[28] *Id.*; *see also R.D. Booth*, 108 TC 524, Dec. 52,097 (1997).

[29] IR-2021-202, Oct. 15, 2021.

[30] *See www.irs.gov/newsroom/general-overview-of-taxpayer-reliance-on-guidance-published-in-the-internal-revenue-bulletin-and-faqs* (last visited Dec. 20, 2021).

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